MINUTES
of the
THIRD MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

August 9, 2013
Room 322, State Capitol
Santa Fe

The third meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2013 interim was called to order by Representative Jim R. Trujillo, chair, on Friday, August 9, 2013, at 9:15 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. Jacob. R. Candelaria
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Sen. William P. Soules
Rep. Luciano "Lucky" Varela

Absent
Sen. George K. Munoz, Vice Chair
Sen. Sue Wilson Beffort
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra

Advisory Members
Rep. Donald E. Bratton
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Mary Kay Papen
Rep. Sheryl Williams Stapleton

Sen. Carlos R. Cisneros
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez

Guest Legislator
Representative Dennis J. Roch

Staff
Claudia Armijo, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, LCS
Pam Stokes, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Friday, August 9</u>

Capital Outlay: Statewide and Local Overview

Sonya Snyder, senior fiscal analyst, Legislative Finance Committee (LFC), and Kathleen Dexter, researcher, LCS, reviewed for the committee the process for selecting and funding statewide and local capital outlay projects. Ms. Snyder reviewed the June 2013 LFC capital project quarterly update of current projects. Several projects were highlighted as being behind schedule. She also discussed recommended legislative guidelines for selecting local capital projects. Ms. Dexter described how capital outlay projects are funded, mostly through severance tax bonds and general obligation property tax bonds. She then presented a list of capital projects that were put on hold by the Office of the Governor because of audit issues.

Committee members discussed with Ms. Snyder and Ms. Dexter the issue of the governor's freeze of some capital projects because some governmental entities had audit problems. Points discussed included:

- whether the governor has the authority to withhold allotments for those projects;
- the need for strict accountability for all money that the state spends;
- the need for more auditors willing to perform audits for small governmental entities;
- the possibility for the Office of the State Auditor to hire temporary auditors to perform audits for small governmental entities; and
- what criteria were used to determine that a governmental entity is "at-risk".

The minutes from the July 10, 2013 meeting of the committee were approved, without changes.

State Investment Council (SIC) Investment Policies, Practices and Returns of Economically Targeted Investments (ETIs); Sun Mountain Capital Report on Private Equity Programs; Albuquerque Economic Development (AED) Report on "Closing Funds" as Economic Tools

Steven Moise, state investment officer, Vince Smith, deputy state investment officer, Sally Corning, partner, Sun Mountain Capital, and Gary Tonjes, president, AED, discussed economic development strategies of their respective institutions. Mr. Moise began by describing ETIs managed by the SIC. The SIC is allowed to invest a portion of the Severance Tax Permanent Fund (STPF) in these investments, which are aimed both to generate revenue for the fund and to stimulate economic development in the state. However, the SIC currently only has nearly 10 percent of the fund, or $370 million, invested in ETIs, due to the lack of market-rate returns available from such investments. The SIC is additionally required to invest one percent of the STPF in the Small Business Investment Corporation (SBIC), and it currently has $47 million invested in that program.

Private equity investments performed poorly in the decade from 1993 to 2003, losing 18 percent of the investment value. However, many of those investments are still active and should pay off when a company is sold or listed on a stock exchange. Since 2004, when the SIC modified its investment strategy, investment returns have increased slightly. The SIC offers loans for New Mexico film productions, but now it only offers loans at a market rate. The former practice of offering zero-interest loans and receiving a share of profits has been discontinued. Although the loan program theoretically helped create film industry jobs in the state, those investments performed considerably below the level of that money had it been invested in U.S. government treasury notes.

The SIC supports ETIs but is now focused on those investments that can bring market-rate returns. It expects to invest about $40 million annually in those companies that have a realistic expectation of bringing a good return to the STPF.

Ms. Corning discussed the private equity investment program that Sun Mountain Capital manages for the SIC. Over $350 million has been committed to 28 different venture capital funds that support New Mexico-based companies. These funds have invested more than $2 billion in 62 New Mexico companies since 1993. The program's financial performance has improved steadily since 2004, and it is currently in line with national venture capital benchmarks. Sun Mountain Capital reviews potential venture capital funds for investment, with about 30 funds being evaluated for every one fund selected. During the economic downturn beginning in 2008, no new money was invested in venture capital funds because the loss in value of the STPF put the existing investments very close to the statutory cap on ETIs invested in the STPF. However, during that time, Sun Mountain Capital continued investing its other money in New Mexico companies. The economic impact of these investments in the state was significant, with nearly $200 million in additional payroll and purchases and the creation of 1,300 new high-salary jobs.

Mr. Tonjes then discussed with the committee deal-closing funds and how they are used to attract economic development. Deal-closing funds are set aside by nearly 40 states to help provide competitive incentives to attract new or expanding businesses to the state. They are usually used for infrastructure investments and are often used in combination with other economic incentives. Several states, including Texas, California and Florida, have sizable funds between $100 million and $250 million, but New Mexico only appropriated $3 million toward these kinds of incentives for the current fiscal year through the Local Economic Development

Act (LEDA). The LEDA allows local governments to offer infrastructure to companies seeking to locate in their communities. Mr. Tonjes also discussed how various states manage and protect investments made with companies, including post-performance awards and clawbacks for non-performing companies.

Committee members made several comments, including the following.

- New Mexico lacks sufficient incentive funding to close deals with relocating companies. Mr. Tonjes said that most of the $3 million allocated for LEDA grants for the current fiscal year has been dedicated. The state needs to allocate between $25 million and $30 million to be competitive with other states.

- Hewlett-Packard, which received millions of dollars in incentives, does not even have 100 employees in Rio Rancho anymore. Clawbacks need to become part of any incentive agreement.

- The regulatory climate in the state does not lend itself to companies expanding their operations. For example, it took several years for Intel to secure an air quality permit from the Department of Environment.

- Providing more cash incentives for companies to locate in the state may mean that New Mexico and other states are engaged in a "race to the bottom" in which a company plays one area against another to secure the best deal possible.

- Clawback provisions need to ensure that a company may not declare bankruptcy to avoid paying the state back if it fails to perform as promised.

SBIC Programs Update

Russ Cummins, executive director and investment adviser, and Joseph Badal, president and chair, SBIC, presented an update on the economic development programs operated by the SBIC. The SBIC was formed in 2001 by statute, with the purpose of creating new job opportunities statewide by making investments with development partners to help fund small businesses. The SBIC program is funded by a one percent allocation of the STPF. The program has lost money since 2007, mainly from losses in the equity program and from management fees. The SBIC has subsequently changed its policy from investing in equity to a lending program, which is performing better. The SBIC implements the lending program through three community development partners, and it has begun the process of negotiating agreements with them to shelter the SBIC from any loan losses. More than $40 million in loans have been made since the program's inception, supporting or creating 6,700 New Mexico jobs.

Benefits of the lending program include: smaller transactions benefit more businesses; the lending program fills a funding gap, since banks tend to have a more conservative lending approach; no management fees or dilution of the investment; and funds tend to be dispersed statewide, rather than concentrated in Albuquerque.

Educational Retirement Board (ERB) Update on Meetings with Stakeholders and Possible Changes to the Pension Plan; Update on Pending Litigation

Jan Goodwin, executive director, ERB, and Chris Schatzman, general counsel, ERB, gave updates to the committee about recent activities at the ERB and pending litigation. Ms. Goodwin discussed possible changes to pension plans to further enhance the actuarial soundness of the Educational Retirement Fund (ERF). These changes are being discussed with ERB stakeholder groups over the summer and include:

- elimination or changing of the return-to-work (RTW) provisions, including requiring certain part-time RTW employees to contribute to the ERF;

- strengthening anti-spiking laws to ensure that the ERF is not negatively impacted by employees who receive a large pay increase and subsequently retire;

- changing the pension calculation for employees who currently are able to work part-time most of their career and then work full-time the last five years in order to receive a full pension;

- implementing a "Rule of 80" reduction factor for certain younger employees who qualify under that rule; and

- changing the service credit multiplier for new members.

Committee members made many comments and posed questions for Ms. Goodwin, including the following.

- Setting strict anti-spiking provisions will hurt teachers who become school principals toward the end of their careers.

- Why does a person who has contributed to the educational retirement system, retires and subsequently becomes an employee again need to make contributions to the ERF, even though that person will see no future benefit from those contributions?

- Salary spiking has never been an issue in the educational retirement system, so there is no need to make any changes to current law.

- Is there evidence to suggest that eliminating the RTW exception for part-time employees earning less than $15,000 annually will have a positive actuarial effect on the ERF? Ms. Goodwin said that the actuarial analyses will be completed soon.

- The ERB needs to better include all stakeholder groups in pension change discussions.

● When the legislature enacted a "Rule of 80" provision, it did not have correct actuarial figures. The result was that the legislation hurt the solvency of the ERF, rather than helping it. Ms. Goodwin said that the ERB mistakenly used pension reduction factors that had been in place for many years, but those reduction factors were also not accurate.

Mr. Schatzman briefly discussed the status of pending litigation in which the ERB is involved. The newest case involves a challenge by some ERB members claiming that recent legislation making changes to current retirees' cost-of-living adjustment is unconstitutional. Arguments in the case are scheduled in September. Other pending cases include whether the 2009 contribution shift that employees were burdened with paying constituted a "taking"; and several related cases involving alleged investment fraud and kickbacks by former executives of the SIC and ERB.

New Mexico Retiree Health Care Authority (RHCA) — Post-Annual Board Meeting Update and Possible Statutory Changes

Mark Tyndall, executive director, RHCA, discussed with the committee recent activities of the RHCA and possible statutory changes to increase the soundness of the Retiree Health Care Fund (RHCF). At the annual RHCA board meeting, the board increased premiums for pre-Medicare retirees by eight percent; increased premiums for the Medicare supplement program by six percent; and reduced the subsidy currently given for retirees with multiple dependent children. The board also confirmed its intent to not have any health plans that will be subject to extra federal taxation for generous health plans, beginning in 2018. The impact of these board decisions reduced the unfunded liability of the RHCF by $200 million.

The RHCA has a five-year strategic plan to increase the solvency of the RHCF through 2043. That plan includes phasing out family coverage subsidies for retirees; increasing cost-sharing on prescription coverage; increasing cost-sharing of pre-Medicare plans; and increasing the employer and employee contribution levels. The increase in contribution levels is the only step in the plan that requires legislative action. The RHCA is recommending that employees gradually pay an additional .75 percent of their salary into the RHCF and that employers gradually pay an additional 1.5 percent.

Questions and comments from committee members included the following.

● What will be the impact on the solvency of the RHCF if the number of public employees does not increase? Mr. Tyndall said that built into the solvency assumptions is an annual payroll growth of four percent. Every .25 percent of payroll less than that amount means one year less of RHCF solvency.

● What will be the impact on dependent children whose health care subsidies are eliminated? Mr. Tyndall said that RHCA rates for dependent children were only slightly lower than those found in the commercial market. He estimated that 500 retirees were impacted with the recent change in subsidy.

- The solvency of the RHCF is much lower than other retirement funds. Mr. Tyndall said that in New Mexico, retiree health care is not a property right, which is true of the pension plans. Some states do not have any retiree health care fund at all and just budget those expenses yearly.

- Favoring generic prescription drugs over branded drugs will have the long-term effect of discouraging drug company research into new drugs.

Judicial Retirement Act and Magistrate Retirement Act Potential Plan Solvency Changes; Report on Stakeholders' Input

Arthur W. Pepin, director, Administrative Office of the Courts (AOC), Oscar Arevalo, chief financial officer, AOC, and Wayne Propst, executive director, Public Employees Retirement Association, presented a recommendation to restructure judicial and magistrate retirement pension plans. The AOC will present two bills in the 2014 legislative session for consideration to reform judicial retirement plans. The bills will be similar to legislation the governor vetoed in 2013, with some important differences. First, the proposal to swap partial funding of the plans from the current use of court docket fees to annual general fund revenues will be removed, since that was a concern of the Office of the Governor. Second, in order to ensure the solvency of the Magistrate Retirement Fund, a one-time $5 million appropriation would be made to that fund. Third, the state would pay the judges' and magistrates' share of salary to the pension funds for those not participating in the plans. Finally, both plans would modify the survivor beneficiary provisions to provide an actuarially sound payout over the lifetime of the survivor.

Questions and comments from committee members included the following.

- It is a strange practice to use docket fees to fund judicial retirement plans.

- Why are there separate plans for magistrates and judges? Mr. Pepin said that judges are not allowed to serve until they are 35 years old. Consequently, they need to contribute more because of their shorter time in office before retirement. Magistrates, on the other hand, are elected every four years, and there is no age restriction for their service.

- There should not be any retirement plans for elected officials, including legislators, judges or magistrates. Mr. Pepin said that the legislature could abolish retirement plans for new judges, but that would do nothing to alleviate the existing $100 million shortfall for current judicial retirement plans. He said that a retirement benefit is an important aspect of a person wanting to become a judge or magistrate.

There being no further business, the committee adjourned at 4:25 p.m.